TRANSPORTATION CROWN CORPORATIONS EMERGING ISSUES

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Strategic Policy Directorate
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PREFACE

In any mixed economy a major function of government is the ownership and control of public enterprises. This raises questions about the effectiveness of government intervention in the marketplace, including accountability and management effectiveness of its Crown corporations.

Transportation Crown corporations are among the largest within the Federal government's portfolio. In recent years concerns have been raised about those which are in competition with and behave similarily to their private sector counterparts. This led to an internal study by Transport Canada which has focussed on the commercial Crown corporations, CN, Air Canada and Northern Transportation Company Limited.

This discussion paper is based on the above study. It highlights and presents issues which we hope will provide useful input to the ongoing public dialogue on transportation Crown corporations. Many of my colleagues in Transport Canada other federal agencies and Crown corporations provided useful input and comments, including S.T. Byerley, A. Elliott and R. Shlachter. The views presented in this paper do not necessarily reflect those of Transport Canada or the Government of Canada.

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CHAPTER 1 - INTRODUCTION

Crown corporations undertake a variety of tasks in the Canadian economy from the operation of museums to the production of nuclear reactors. In certain sectors, such as transportation, communications and utilities, where government enterprises are numerous, it has been estimated[1] that employment by Crown corporations represents approximately one-quarter of the total labour force.

The Lambert Commission[1] identified 22 Crown corporations (Appendix A) involved in transportation within the portfolio of the Minister of Transport, through whom each reports to Parliament. Some of these corporations and particularly **Canadian National (CN), Air Canada (AC) and Northern Transportation Company Limited (NTCL)** operate in a commercial and competitive environment, exhibiting similar economic behaviour as their private sector competitors.

The above three commercially-oriented transportation Crown corporations play a significant role in their respective major areas of economic activity, i.e., rail freight services (CN), air passenger operations (AC) and marine transportation services in the North (NTCL).

In recent years they have been profitable (subsequent to recapitalization). In the case of CN and AC, they have been able to raise funds required for capital investment in the private capital markets. All three corporations have exhibited high levels of productivity and efficiency, both in absolute terms and in comparison with their international or national competitors.

However, a number of questions have arisen during the past years as to whether the future direction of these corporations corresponds with government policies and the role government wishes the corporations to fulfill. The issues which require consideration revolve around the future role and objectives of these corporations, their diversification plans and financing requirements and a framework for measuring financial performance.

This paper discusses the issues of role, diversification, financing requirements and performance measurement and identifies some of the factors which should be taken into account in addressing those issues.

[1] Royal Commission on Financial Management and Accountability, (Lambert Commission Report), Government of Canada, March, 1979.

The paper is composed of two parts. The first presents background on the government's historical relationship with Crown corporations, changes proposed to the existing relationship and the various means by which government interacts with Crown corporations. The second part discusses policy issues of concern to Transport Canada, i.e., role, diversification, future financing and performance framework.

Over the years the question of **privatization**, i.e., the sale of a Crown corporation to the private sector, has been raised and debated. Privatization could cause significant structural shifts and should emanate from explicit government policy. It is tied closely to the political philosophy of the government of the day, its objectives and economic and market circumstances. The purposes of this paper, as explained above, however, are more modest. It is assumed that the government intends to retain ownership of the Crown corporations discussed herein.

CHAPTER 2 - BACKGROUND

This part presents a brief summary of the rationale for the creation of Crown corporations and the legislative provisions which form the basis for the government's relationship with the Crown corporations, i.e. the **Financial Administration Act** (FAA). Proposed changes to the FAA regime of direction, control and accountability regarding Crown corporations, as outlined in Bill C-123[2] and the Lambert Commission Report[3] are then presented.

The final part of this background summarizes the various mechanisms by which the government interacts with Crown corporations including Constituent Acts, the **National Transportation Act**, budgetary control, policy direction and moral suasion.

2.1 Genesis and Rationale

Crown corporations have been established for various purposes.[4] However, each was constituted to serve the national interests of Canada through the achievement of broad policy objectives.

The creation of the Canadian National Railways in 1919 has generally been seen as the first major venture into public enterprise, although the National Battlefields Commission, established in 1908 to restore and preserve historic battlefields of the Province of Quebec, is the oldest of the existing Crown corporations.

The largest growth in the establishment of Crown corporations came during World War II. The requirements of the War demanded that the government resort to an organizational form which could operate without the personnel and budgetary constraints of normal departmental administration. In establishing Crown companies to assist in the War effort, the government was also using an organizational form that would be attractive and familiar to businessmen drawn from the private sector. A large number of the wartime Crown corporations were dismantled at the end of the war. However, many continued and were augmented by additional companies established during the reconstruction period.

The speed with which Crown corporations were created and the diversity of purposes for which they were established during World War II meant that effective systems of control, direc-

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[2] Tabled in Parliament, June 30, 1982.

[3] op. cit., Royal Commission on Financial Management and Accountability, 1979.

[4] "Crown Corporations - Direction, Control, Accountability", Privy Council Office, 1977.

tion and accountability were not defined in any comprehensive way.

It should be noted that in recent years the government has benefited in a number of ways from corporate ownership. Some of these advantages have been:

- the use of Crown corporations to help promote regional and industrial development through the implementation of procurement policies;

- the use of Crown corporations to promote Canada internationally; and

- the use of Crown corporations to implement government policies such as bilingualism.

The government has not always used Crown corporations to implement its policies due to the multitude of objectives it is attempting to fulfill. However, Crown corporations can be used to achieve government objectives if the private sector cannot or will not respond effectively.

2.2 Government Relationship with Crown Corporations; The Post-War Period

Part VIII of the **Financial Administration Act** (FAA), enacted in 1951, was intended to lay the foundation for a more uniform and systematic financial relationship between the government and Crown corporations on one hand, and the government and Parliament on the other.

The FAA addressed only issues of financial direction, control and accountability, not policy direction and control.

From 1951 until the mid-1970s, by which time the number, size and importance of Crown corporations had grown immensely, there had been little progress in further defining the role of Crown corporations, their relationship with the appropriate Minister, government and Parliament and the role of management in Crown corporations.

2.3 Recent Initiatives

Two recent initiatives have proposed major changes to the relationship between the federal government and Crown corporations: first, the Lambert Commission Report released in 1979, and second, Bill C-123 introduced in 1982.

The Lambert Report (1979), dealing with the subject of Crown corporations, concluded that there had been an inconsistent application of an accountability framework for crown agencies. Lambert indicated that accountability to Parliament for mandate and to the government for policy was not ade-

quately covered in the FAA regime of accountability which is tied to financial management.

The recommendations of the Lambert Commission Report that dealt with Crown corporations revolved around the identification of the essential elements of an accountability regime. This would consist of:

a) The formulation of a corporate **mandate** consisting of its role and objectives, powers and organizational structure;

b) The provision of instruments for **direction-setting,** by submission of a corporate plan to the designated Minister to ascertain whether corporate strategy is consistent with the policy of the government and the provision for ministerial directive power to resolve conflicts between the corporation's interpretation of its public mandate and the government's views;

c) **Control** instruments such as the appointment and removal power of Boards of Directors, the Chairman of the Board and the Chief Executive Officer, and budgetary approval; and

d) **Reporting and evaluation** procedures such as audits, quarterly and annual reports and reviews.

On June 30, 1982, Bill C-123, the Government Organization Act, 1982 was tabled in Parliament. This Bill contains proposed amendments to the FAA affecting Crown corporations. The major elements of the Bill of interest to transport Crown corporations include the following:

a) A definition of a wholly-owned corporation, i.e., a Crown corporation in which all of the issued and outstanding shares are held, or all of the capital is owned, by the government, or all of the directors are appointed by a Minister or Governor in Council;

b) The granting to Governor in Council of the same rights and powers as the sole shareholder of a corporation incorporated under the Canadian Business Corporations Act;

c) The requirement for Governor in Council approval for the incorporation of a corporation in which the government has a proprietary interest or to acquire the shares of a corporation the result of which is the government's proprietary interest in the corporation;

d) The procurement of incorporation of a corporation and the acquisition of all its issued and outstanding shares by any Minister subject to Governor in Council approval;

e) The approval of Governor in Council is required for the sale or other disposition of shares or the sale of assets, other than in the ordinary cause of business, of a wholly-owned corporation;

f) The provision to Treasury Board by every wholly-owned corporation of any information which the Board considers necessary for the performance of its duties;

g) The annual submission to the appropriate Minister by each agency and proprietary corporation of a coporate plan for Governor in Council approval;

h) The prescription by Treasury Board, by regulation, of the form, content and submission dates of budgets and corporate plans; and

i) The approval of the Minister of Finance is required, through the appropriate Minister, before a wholly-owned corporation borrows money.

2.4 The Existing Policy Framework

The previous section outlined the present general regime of direction, control and accountability over Crown corporations, together with changes which have been proposed to date. However, there are also various mechanisms by which the government, Parliament, or the Minister of Transport, interact with the transportation Crown corporations. While this section summarizes these various means, it does not judge their relative effectiveness or suggest that they have all been used.

The clearest mechanism is the Constituent Act. Other acts provide for the regulation of carriers with regard to entry and exit controls and prices, although in some cases, Crown corporations are handled differently. Additional mechanisms include budgetary controls, policy direction, moral suasion and parliamentary committees.

a) **Constituent Acts**

i) **Organization and Role**

Both Air Canada and CN were established by special Acts of Parliament which specify the types of activities each company can engage in[5]. Both companies are permitted to engage in transport related business in addition to their basic air and rail operations. For Air Canada, this in-

[5] See Appendix B for a description of CN, AC and NTCL, with a brief summary of their legislative powers and an outline of their objectives and roles as viewed by their corporate management.

cludes tours, catering, reservation services, computer and teleprocessing systems, and technical and consulting services. For CN, this includes express, telecommunications, trucking, vessels, docking and warehousing, hotels, land, offices and other buildings. Other activities, best described as "non-transport", require the approval of the federal government.

Major differences between the AC and CN constituent acts are:

- the Minister of Finance holds most of the capital stock of CN in trust for the government while the Minister of Transport is the trustee shareholder for AC;

- the Governor in Council may issue "directives of a general nature" to AC, but this is not explicitly provided for CN.

NTCL was established by letters patent (under the **Canadian Business Corporations Act**) which gives the company the capacities, powers, and rights of a natural person. The shares of NTCL are held in trust for the Government of Canada by the Minister of Transport.

ii) Appointment of Boards of Directors

A major vehicle of control by government over Crown corporations is the appointment and removal of members of the Boards of Directors, a view expressed in the Lambert Commission Report. This power is provided for in the constituent acts of AC, CN, and NTCL. Given that government control of Crown corporations is partly through the medium of the Board of Directors, the government's ability to effect such control or direction is related to the circumstances, qualifications and character of the persons selected for appointment to such Boards.

b) **Proposals for Crown Corporations Legislation**

A Government Organization Bill (C-123) which includes changes to that part of the Financial Administration Act dealing with Crown corporations was introduced in Parliament on June 30, 1982 as indicated earlier. The highlights of the Bill were outlined in Section 3 above.

The Bill is a response to various problems which have arisen over the past five to ten years. The lack of clarity of the role of Parliament and government in the financial management and control of Crown corporations has led to questions over their accountability as raised by the Lambert Commission and the Auditor General.

The proposed amendments to the FAA are expected to improve the regime for the direction, control and accountability of Crown corporations through enhancing the government's overall capability to act as an effective shareholder.

c) <u>**The National Transportation Act**</u>

The NTA does not explicity treat Crown corporations differently from privately-owned companies. The NTA declares the intention that the transportation system be economic and efficient and that this state is more likely attained under conditions of modal competition **"having due regard to national policy and legal and constitutional requirements".**

This philosophy has been adopted by Crown corporations with commercial objectives as the rationale for expecting compensation for unprofitable routes and facilities. This philosophy has been applied in selected situations (rail branchline abandonment) which have benefited Crown and private corporations alike. Crown corporations are expected from time to time, however, at the request of their government-owner, to undertake activities which are not profitable but in the national interest, with the manner of compensation, if any, to be determined by the government.

d) <u>**Modal Acts**</u>

Modal acts, such as the **Railway Act** and **Aeronautics Act,** contain provisions which generally apply equally to Crown and private corporations. The intent of Parliament is to regulate the safety and economic aspects of transportation in a like manner for both kinds of companies.

e) <u>**Budgetary Control**</u>

General financial control, direction and accountability of all Crown corporations are spelled out in the **Financial Administration Act** (FAA).

Under this statute, CN, AC, and NTCL are considered as Schedule "D", or proprietary corporations; they are responsible for managing commercial operations which supply service to the public and are normally required to conduct their operations without appropriations. This requirement has been interpreted to mean that this type of corporation is expected to operate on a commercial basis similar to a corporation in the private sector. They are required to submit annually a capital budget for approval by Governor in Council on the recommendation of

the Minister of Transport, the President of the Treasury Board and the Minister of Finance.

f) **Policy Direction**

Policy direction can consist either of general statements of governmental policy which apply to an industry or group as a whole or specific statements which pertain directly to Crown corporations. This latter type of direction, which emanates from the government as part of its role as a shareholder, has not been and is not a major control mechanism for Crown corporations. At present, Governor in Council can issue directives of a general nature to Air Canada. In addition, the Treasury Board requires all Crown corporations to include in their capital budgets a statement of the impact of the budget on national policies or priorities.

Policy direction is a strong tool which could be used to influence the overall direction of a particular Crown corporation or of a group of Crown corporations.

g) **Moral Suasion**

Meetings between the Minister and senior officers (Chairman/President) of Crown corporations or among senior officials in Crown corporations and in the federal government can be opportunities for discussion of major issues which either party feels can be resolved by action on the part of the other. These informal meetings can be used to discuss issues or policies which are not fully defined. Moral suasion can also be used as a kind of early warning signal of potential problems.

In the transport sector, this mechanism has been the predominant way to influence the actions of the Crown corporations.

h) **Parliamentary Committees**

Under the statutory provisions establishing Crown corporations such as CN and AC, provision has been made for various reports, such as those submitted annually by the Board of Directors and auditors, to be referred to a Committee of Parliament formed to review matters relating to transportation. The opportunity for members of Parliament to question senior executives and officials of Crown corporations regarding corporate operations and policies and for corporate officials to expound on problems facing them provides another valuable forum to discuss any major issues which the corporations will have to resolve in the future.

2.5 Summary

Crown corporations have been created as a means of achieving public policy objectives with a degree of independence ranging from close financial and personnel government controls to virtual autonomy from Parliamentary/government review.

There are numerous mechanisms at the disposal of the federal government and Parliament by which it can influence the behaviour of Crown corporations.

The present general regime of financial direction, control and accountability over Crown corporations is embodied in Part VIII of the **Financial Administration Act** which was enacted in 1951. However, in June 1982, proposals for changes in the relationship between the federal government and the Crown corporations were tabled in Parliament in a Government Organization Bill (Bill C-123) as a result of concern for the existing regime of direction, control and accountability of Crown corporations. (In addition, the 1979 Lambert Report, in dealing with the subject of Crown agencies, also concluded that there had been an inconsistent application of an accountability framework for Crown agencies.)

The other various mechanisms by which the government or the Minister of Transport can interact with the transportation Crown corporations and can influence their behaviour include constituent acts, regulatory acts, budgetary controls, policy direction, moral suasion and Parliamentary Committees.

Thus, the question for resolution is not whether policy mechanisms exist; rather, it is first what the government wishes the commercially-oriented Crown corporations to do and then to select the most effective instrument to ensure this is done.

In trying to determine what these commercially-oriented Crown corporations should do, a number of issues have arisen concerning their relationship with the government. For example, what is the role of these Crown corporations? How should a Crown corporation interpret the government's objectives? What factors should be considered when a Crown corporation diversifies? The next part deals with these issues and others.

CHAPTER 3 - POLICY ISSUES

3.1 Introduction

Crown corporations, as corporate enterprises, are subject to all the legislation and regulations which govern the industries to which they belong. However, as shown in the previous part, there are also a variety of other mechanisms through which government, as owner-shareholder, and Crown corporations interact. In some cases, government has taken the initiative in asking or directing certain courses of action -- most notably and basically in the Constituent Acts. In other cases, the Crown corporations have taken the initiative in undertaking certain actions -- most frequently, in purchasing or establishing other corporations. These two general courses of action reflect respectively the **roles** which government and Crown corporations see for the corporations. When government and Crown corporations share a perspective on the role of the Crown corporations (either as the result of consultation and discussion or similar views) there is obviously no conflict and no issue to be resolved. When government's perspective and that of the Crown corporations diverge, resulting in different courses of action, issues arise which require resolution. This part will identify several key issues arising from divergent perceptions of the role of Crown corporations.

Ongoing and anticipated action on the part of the three major transportation Crown corporations, when viewed in the light of existing and emerging government objectives, yield three major policy issues: diversification, future **financing** and a **performance framework.** (These issues are discussed in detail below.) No matter how these issues are defined and regardless of the options available to resolve them, any solution will depend on how one perceives the role of the Crown corporations. The following section discusses the roles of CN, Air Canada and NTCL as a basis for dealing with the three issues identified above.

3.2 Role of Crown Corporations

The role of a Crown corporation cannot, and perhaps should not, be defined in a rigid way. This is because a corporation is a dynamic institution which tends to grow and change over time rather than move within fixed limits. To define a role for a Crown corporation, it is necessary to recognize the evolutionary nature of corporations: that is, the corporation has a principal role and, in carrying out that role, it becomes involved in other activities which either enhance or detract from its principal role.

In attempting to define a corporate role, it is also important to remember that both the industries in which the Crown corporations are situated and the policies of the shareholder which owns and controls the corporations, have also evolved since the original objectives of the corporations were established. These changes make it difficult to determine a definitive role for each corporation. Rather, it makes it essential to re-examine the corporate role from time to time.

Government involvement in Crown corporations is three-fold: a) to define, with the corporation, its principal role; b) to determine how successfully the corporation is carrying out its principal role; and c) to assess in the light of its principal role other activities in which the corporation is engaged.

The federal government is the only shareholder for Air Canada, Canadian National and NTCL. It is by virtue of this position that the government can and should act in developing a role for the three corporations. While shareholders' objectives, as they apply to private corporations, are relatively straightforward (dividends, growth, market shares, capital gains), the objectives of government are more complex since it is concerned with a variety of political, social and economic concerns as well as by profit-oriented goals for the Crown corporations.

As mentioned above, the objectives of government, as they relate to Crown corporations, can be defined in three dimensions: defining a role for the corporation; determining whether the corporation is playing that role; and assessing new activities in the light of the principal role. The following paragraphs set out a conceptual approach to the interaction between the government and Crown corporations in defining and refining their roles.

Crown corporations have been established to fulfill certain functions. CN was established by the government to ensure that an adequate railway transportation system would be maintained and to protect its investment interests. AC was established by the government to provide a level of transportation service in the air mode. The role of NTCL, originally incorporated as a subsidiary of Eldorado Nuclear (formerly Eldorado Gold Mines Ltd.), has evolved to its present position as a northern marine and motor carrier. In many aspects, CN, AC and NTCL are not significantly different from private corporations. However, it can be argued that the main difference (and the way in which the corporations respond to public goals) is to provide transportation services that respond to government's social and economic objectives more effectively than those provided by private corporations.

Having established commercial Crown corporations, the government has been faced with the natural evolution of these corporations and the industries of which they form a part. Rail and air carriers are companies much different now than they were 25 years ago. For example, both CN and CP Rail now are able to offer shippers a variety of multimodal services that were not available 25 years ago. It is clear that this kind of evolution -- expanding into related fields by buying or establishing other companies -- has benefited the public and led to better transportation service. There is clearly no conflict between private and public goals in this kind of changing role.

The potential for conflict arises when Crown corporations begin to acquire or establish companies more with a view toward profitability than a concern with expanding the services, transportation or other, which they are legally permitted to provide. This is normal for private corporations in search of profits but not necessarily for Crown corporations. The government, for its part, may well be inclined to accept such behaviour because Crown corporations with profitable "sidelines" would be less inclined to seek financial assistance from government for unprofitable services and might be able to finance expansion projects from retained earnings in lieu of government loans or equity infusions. After some years of pursuing profit goals, Crown corporations would be subject to some questions regarding their roles; they would certainly not be an exclusive means of serving a national purpose nor would they be as free as private corporations to pursue profit goals.

The central issue for the government is how to guide the natural commercial instincts (of pursuing profit goals) and practices of commercial Crown corporations once their role has been identified. The issue is not whether Crown corporations should pursue profits but the extent to and the means by which such activities reduce or enhance the ability of the three corporations under study to perform their principal roles.

The government has three options by which it can more actively affect the direction of Crown corporations in accord with their stated roles.

a) <u>The Financial Administration Act and Present Informal Understandings</u>

At present, the capital budget submission is the major mechanism whereby corporate objectives and plans are brought before the government. Less formal, but potentially more effective is moral suasion, whereby the Minister of Transport and senior Transport Canada and Crown corporation officials meet informally to discuss issues and direction of corporate and government policy.

While informal mechanisms can be effective, there is no ongoing and clear relationship which could provide public policy input to the direction of Crown corporations.

b) **More Government Controls, a New Crown Corporations Act**

Definitive long-term plans and policy guidelines and procedures for Crown corporations could be developed and agreed upon by both the government and the corporations. This would greatly increase the direction, control, and accountability of the corporations and would define the role of each of the participants responsible for the direction of the corporation. However, this formal type of structure could create problems for the commercial Crown corporations, particularly in the area of responding to investment opportunities which occasionally arise.

c) **Policy Guidelines from Minister Responsible for Corporation**

An approach which combines the best elements of the present system (informal high level discussions) and of a formal structure (a role statement, policy direction, guidelines for financial behaviour and a framework for measuring corporate performance) represents a third option. This approach would reduce the uncertainty of the status quo and still provide the necessary flexibility that commercial Crown corporations need to operate effectively in competitive markets.

The discussion presented in the following section regarding the issues of diversification, future financing and performance framework are based on the third approach, which might be identified as the "middle-of-the-road" approach.

3.3 Diversification

Diversification, in the context of this paper, is the purchase (or creation) by a Crown corporation of an interest, either partial or total, of a corporate entity which entails new activity by the Crown corporation. This would include, in the case of CN, its investment in Cast and in the case of Air Canada, Guiness Peat Aviation Ltd. These investments led to CN's involvement in a North Atlantic container line and to Air Canada's involvement in a firm which acts as a lessor and broker for new and used commercial aircraft.

The questions here should not be whether Crown corporations should diversify (it is assumed that they will continue to pursue diversification opportunities in the future); such a prohibition for further diversification, while attractive to persons who view CN as a pure rail carrier and Air Canada as a pure air carrier, would result in Crown corporations which

would be at a disadvantage[6] vis-à-vis their private sector competitors. Transportation, like most other industries, has a natural economic life cycle; during the mature phase of the cycle, financial problems can occur especially in periods of economic difficulty. In such a situation, diversification, especially that which can capitalize on the corporation's proven strengths, becomes very important as a means of support for the transportation side.

Rather, the relevant questions are:

- what kind of diversification is appropriate for Crown corporations like CN, AC and NTCL as ancillary and in support of their main operations;

- what factors should be taken into account in determining the appropriateness of particular diversification processes;

- the timing of government approvals of such purchases, i.e., should there be a screening process (over and above the Canadian Transport Commission's screening process which applies to all transportation carriers) before a final decision is made or should there be a ratification process with the Crown corporations agreeing to purchases on an **ad referendum** basis.

In the normal course of events, proposals for diversification originate with Crown corporations themselves. Their rationale has been, and is expected to continue to be, to retain and/or strengthen their commercial viability and long-term financial stability, i.e., to protect their financial well-being. Additional factors within the purview of the corporations have been increased efficiency and productivity.

From the perspective of the federal government, three factors are important in determining the appropriateness of diversification proposals: a) promotion of efficiency and productivity of the transportation system; b) the role of the Crown corporation; and, c) impact on government finances.

a) **Promotion of Efficiency and Productivity**

Approval of a proposed diversification should be based on the extent of increase in productivity and efficiency of the transportation system, and not just that of the Crown corporation. Diversification proposals resulting in pro-

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[6] It should be noted that Crown corporations do have some advantages over their private sector counterparts in terms of financing; for instance, any funds borrowed from the government are available at less than market rates and borrowing in the capital markets may also be at preferred rates as a result of higher investment ratings due to implied support by the government.

ductivity and efficiency gains for the existing transportation system should be favoured. On the other hand, if a proposed diversification will not significantly alter and augment the existing efficiency and productivity of the transportation system, then the need for additional public ownership and presence in the market place should be questioned. Diversification resulting in transfer of ownership from the private to the public sectors without added benefit to the transportation system should not be encouraged.

b) **Promotion of the Role of Crown Corporations**

Another relevant factor in the approval of diversification proposals is the extent to which they will promote government objectives and more particularly the principal role of the Crown corporations.

A variation of this factor in market or economic terms is whether the diversification constitutes vertical or horizontal integration as it relates to the corporation's role.

Vertical integration is the purchase of a corporation providing inputs to the holding company (e.g. the purchase by automobile manufacturers of auto part suppliers) or market outputs of the existing company (a consulting arm). Vertical integration, if closely related to the role, could be desirable; for example, CN's purchase of a trucking company as a feeder carrier (subject to the regulatory approval process under Section 27 of the NTA).

Horizontal integration, however, such as CN's purchase of an oil and gas company, could lead to a much different corporation than appears to have been contemplated by the CN Act. In addition, horizontal integration could result in a complex corporation spread through many sectors of the economy (e.g., transportation and energy). This indicates that proposals leading to horizontal integration need to be questioned and investigated to a greater degree than the vertical integration ones, since they may detract from the principal role of the corporation.

The investment of corporate pension plan funds is of particular importance when dealing with the diversification issue. At the present time, under the Pension Benefits Standards Regulations of March 1, 1981, funds from corporate pension plans may be invested in such securities as preferred or common shares of a corporation, provided the corporation has achieved a certain earnings or dividend record. Pension fund investments may also be made in a wide range of assets including real estate that yields petroleum or natural gas or an interest in a petroleum or natural gas lease on real estate in Canada,

subject to certain conditions and restrictions on the amount of the pension fund that may be invested in such assets. However, the benefits from such investments accrue to the participants in the fund and not the corporation itself; thus, any guidelines on diversification in this paper should not be extended to pension plans.

In the case of transportation, it is more difficult to determine the difference between horizontal and vertical integration than it is for other industries because of the derived demand nature of transportation. It is difficult to imagine many commodities that do not require some mode of transportation to move them from their point of origin to the final consumption stage.

Hence, in trying to categorize a diversification proposal of the commercially-oriented transportation Crown corporations as being either vertical or horizontal, it is difficult to find a commodity that could not conceivably constitute an input or output to the business of the particular corporation and be considered a form of vertical integration. In the case of CN, any goods that it purchases from a supplier, or any commodity that it transports, might be considered as an area of opportunity for vertical integration.

However, for the purposes of this paper, a delineation has been made between vertical and horizontal integration on the basis of the degree of market penetration of a particular product activity into which the Crown corporation wishes to diversify. For example, CN, as a railway, has a major impact on the railway rolling stock market in Canada as it represents one of the few purchasers of this particular product. The survival of the rolling stock manufacturing industry is very dependent on CN's continuing demand for equipment. Thus, CN, hypothetically, could be allowed diversification in this particular industry to ensure its continuity in Canada.

On the other hand, CN as a railway and trucking company is only one of many purchasers of the by-products of the oil and gas industry and thus, its impact on the resource industry is not as great as in the previous case; in other words industry survival is not dependent on CN's demand for that product.

c) <u>Impact on Government Finances</u>

The last important factor in the approval of proposed diversifications is their impact on government finances, i.e., the short- and long-term impact on the government in terms of equity purchased, dividend receipts, tax revenues, etc.

As indicated in the following section on future financing, the Crown corporations will require large amounts of capital over the next decade to finance their planned capital expenditures. A substantial proportion will have to be funded externally through debt instruments in the private capital markets. In order to reduce corporate financial risk and maintain financial well-being, some equity financing may be required by the federal government.

The question is what impact the diversification proposals will have on the immediate requirement for external financing and consequently on the provision of government equity. Does the government, given the continuing emphasis on expenditure restraint, have the budgetary resources available to invest in the Crown corporations?

The degree of diversification will also have an impact on the future cash flows of the Crown corporations. What will the impact be on their ability to pay dividends to the government on its equity investment and also on the tax liabilities to the government?

Conclusions

The following factors should be taken into account in determining the appropriateness of particular diversification proposals:

i) Does the proposed investment contribute to the long-term commercial viability of the corporation?

ii) Does the investment augment the productivity and efficiency of the existing transportation system or does it simply result in a transfer of activities from the private to the public sector without added benefits to the system?

iii) Is the investment in support of the principal role of the Crown corporation?

iv) Is the financial burden on the government, either in terms of funds required from government or in terms of possible dividends or taxes to be paid to the government reasonable and affordable in the short and long term?

It is also possible that a diversification may be proposed by the government. In such an instance, the factors referred to above are expected to be taken into account by the government in its approval process.

3.4 Future Financing [7]

As indicated previously, the major issue facing CN, AC and probably NTCL over the next decade will be the large capital expenditures required to finance equipment and plant replacement and expansion. Assuming their continuing role as commercially-oriented Crown corporations, it is clear that these expenditures must be made to maintain their positions in the marketplace.

Attempting to limit future expenditures to that which could be financed only through retained earnings might allow for some growth during periods of high profitability but during down cycles of the economy the flexibility for long-range capital planning could be seriously constrained.

Thus, in order to continue to grow as viable commercial enterprises, external financing will be required by the Crown corporations. External funding can be raised in two ways, either through the use of debt instruments (loans, bonds, leasing, etc.) or through the sale of equity (common or preferred stock).

Financing totally by debt is not regarded as financially healthy for any corporation; the financial risk involved in having to meet annual debt obligations in uncertain economic conditions is great, making further infusions of capital difficult to obtain.

The problems associated with high debt were recognized in the 1976-78 period when recapitalizations were approved for CN, AC and NTCL. In particular, it was recognized that CN and AC should have capital structures similar, but not necessarily identical, to their similar-sized industry counterparts in North America in order to be able to compete on the same basis.

External funding required over the next decade by CN and AC to finance planned capital expenditures will likely necessitate some equity financing. In the case of CN, government equity of $1.5 billion may be required by 1986 if other solutions are not found to the ongoing financial constraints of Crow's Nest, CN Express, Terra Transport and Montreal commuter services. Concerning AC, the company projects an increase in the debt/equity ratio by 1984 as a result of the level of external (debt) financing required. In order that the level of debt does not grow beyond its corporate preferred level, i.e., not significantly higher than its private sector competitors, government equity financing will be required. However, in approving the recapitalizations for

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[7] The question of the government's financing of Crown corporations is within the purview of both the Minister of Finance and the President of the Treasury Board; the views expressed in this section do not necessarily represent their views.

corporations were responsible for maintaining an appropriate debt/equity structure through good management and that no equity appropriations would be sought in the future.

The various options available to resolve future financing relate to the source and method of equity financing, viz:

a) **Debt/Equity**

The debt/equity levels of Crown corporations should be of concern to the government and need to be reviewed periodically. The suggestion that the debt/equity ratio is not important is not acceptable because significantly different degrees of debt/equity may have a differential impact on the market behaviour and morale of senior management of Crown corporations. For example, a 100% equity position might result in a feeling of complete protection of the Crown corporation by the government and in a perception that it does not compete on equal terms with its competitors, thus undermining the spirit of entrepreneurship. The debt/equity structure provides a degree of market discipline which is considered important for a well functioning market corporation, because the corporation would feel, at least in part, accountable directly to the market (through debt).

While it is recognized that the ability of any corporation to raise required financing in the capital markets is affected, inter alia, by its debt/equity ratio, in the case of Crown corporations, their status as Crown agencies provides them with other advantages vis à vis their private sector competitors which may offset a perceived unfavourable capital structure.

b) **Private Equity**

Under the expanded definition proposed in Bill C-123, a Crown corporation includes any corporation all of whose shares or capital are owned by the government. If the corporations were given the legal power to attempt to raise equity funds in the marketplace, leaving the government only as a majority shareholder, the use of the corporation as a means of serving a national purpose would be constrained by the wishes of the minority[8] who would likely be interested in profit maximization and return on investment. (Subsidiaries or joint ventures are considered in this paper to be excluded from this constraint.)

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[8] Refer to Section 140 of the **Canada Business Corporations Act** and the **Business Associations Casebook,** S. Beck, Getz et al, Richard de Boo Ltd, 1979.

More specifically, private equity would result in the government becoming a majority or minority shareholder and the corporation becoming subject to the **Canada Business Corporations Act.** The legal requirement to protect minority shareholders' interests could create difficulties for meeting the public interest objectives. Shareholders would have a right to legal redress when corporate actions which are not legal requirements are undertaken with the foreknowledge that profitability will not be maximized. Direction by the government would often fall into this situation.

c) **Government Equity**

Provision of equity by the government could be achieved in a number of ways:

- undertake periodic recapitalizations, i.e. conversion of outstanding debt to equity, removing the necessity to pay these obligations;

- allow the corporations, e.g. AC, to retain any dividend payments that they might have made to the government (under the terms of the 1978 CN recapitalization, CN must pay a 20% dividend to the government on earnings remaining after payment of interest and taxes); or

- in the case of CN, resolve some of the present financial constraints (grain rates, Terra Transport, CN Express, etc.) which would increase revenues and facilitate borrowing requirements.

The payment of compensation to Crown corporations for losses incurred as a result of compliance with a government directive is one means of ensuring their commercial viability is not impaired. If for some reason, compensation payments were not made, any adverse effect on the "bottom line" should be taken into account when assessing corporate performance. At present, compensation may be provided to AC under Section 9 of the Air Canada Act 1977.

The continuing government policy of restraint means that the funds required for direct investment might be difficult to find. However, to ensure the continued viability of these Crown corporations, the government may have to be prepared to set aside some funds for them assuming that it wishes to have a continuing influence over their future roles.

d) **Divestiture**

Divestiture within this paper means the selling off of a portion of a Crown corporation to the private sector. It

could also include the winding-up of Crown enterprises with their functions taken over by the private sector directly or on the basis of contracts with the government.

A major benefit of divestiture of components is a reduced requirement for external financing. In the light of current government expenditure restraint and economic development objectives, divestiture can be used as an additional source of funds.

In looking at divestiture, the areas most likely to be of interest to the private sector would be the profitable parts of the Crown corporation. This might result in the corporation retaining only the public interest services, thus threatening the commercial viability of the whole company. Thus, any divestiture proposal must be considered in the context of a longer term corporate plan to ensure the principal corporate role is not affected in an adverse manner.

e) **Privatization**

Privatization can be a general source of government financing. However, as explained in the Introduction we are not addressing the privatization within this paper because of its broader consequences beyond the purposes of this paper.

3.5 Performance Framework

In a commercial setting, financial measures of performance are fairly standard. They consist of profitability, return on investment, market shares, liquidity ratios, etc., indicators that are very objective and relate almost totally to financial performance. These may be compared with the industry as a whole to determine a corporation's performance vis-à-vis the industry norms.

Services provided by Crown corporations are undertaken both with a view towards commercial viability and to achieve other government objectives. Corporate performance must recognize both types of goals; this would lead to the acceptance of a lower overall return on total investment or the separation of non-profitable operations undertaken in response to specific government objectives and criteria from the commercial parts of the corporation.

The traditional approach toward the measurement of performance of Crown corporations is, for example, to calculate return on investment based on market criteria and to interpret the result in the light of activities which the government requires the corporation to undertake. Since it is difficult to know how much to discount for non-commercial

activities, and since little direction is given currently to Crown corporations as to how these activities should be accounted for, it is difficult to judge performance. There are alternative approaches which could be used to measure annual corporate performance; one is based on the development of annual goals or performance agreements and another is based on a comparison of performance against a longer term corporate plan.

a) **Goal and Performance Agreements**

Specific government-directed activities could be identified by Crown corporations and some recognition of these could be made by the government in assessing their performance. For example, a particular government-directed activity may be undertaken by a Crown corporation within its total system, albeit at a loss, and the costs (and revenues) associated with such an activity could be separated out from the corporation's commercially-oriented activities and not be included in the determination of the corporation's annual return on investment or profitability targets. The alternative would be to include the costs (and revenues) associated with undertaking government directed activities in the corporation's "consolidated" accounts and develop (lower) profitabiltiy goals which take into account these imposed unprofitable public duties.

b) **Use of Approved Corporate Plans**

This is a broader based approach than that described above, and is in line with the control mechanism that is advocated in Bill C-123.

To ensure that the role, once defined, is properly interpreted by the corporation, it is necessary to have some control mechanism. Such a mechanism is a corporate strategic plan, in line with the Lambert Commission and Bill C-123, which would outline the corporation's objectives, its plans for the upcoming planning period (3-5 years), the relationship of these plans to its role and mandate, the timing of its plans and the amount of financial support required. Thus, the combination of role and corporate plan becomes the framework for measuring corporate performance.

The results would be documented in the corporate plan submitted in the subsequent fiscal period. The Crown corporation and the government could then jointly determine the reasons for any variations from the corporate plan to determine to what extent and why the variations were due to circumstances beyond the control of the Crown corporation. This would form the basis for assessing management performance.

CHAPTER 4 - SUMMARY AND CONCLUSIONS

Each Crown corporation was created as a means of advancing the national interests of Canada at a particular point in its history. They exhibit degrees of independence which range from close government financial and personnel controls to virtual independence from Parliamentary/government review. Direction, control and accountability over Crown corporations is presently laid out in Part VIII of the Financial Administration Act (FAA). However, the FAA addresses itself only to the financial relationship between the Ministers and Crown corporations on one hand and the Ministers and Parliament on the other; policy direction, control and accountability are not addressed.

Two recent initiatives have proposed changes to the FAA regime of direction, control and accountability over Crown corporations. These changes include the provision of a mechanism, whereby government may communicate broad policy objectives to the Crown corporations through its status as a sole shareholder. However, the question of the manner of communication of more specific policy direction to the Crown corporations and the content of this direction is not dealt with.

Concern has been expressed recently with respect to whether initiatives proposed by the three major commercial, competitively-oriented Crown corporations in the transportation sector, Canadian National, Air Canada and Northern Transportation Company Limited, correspond to the government's view of and concerns with the long run interests of the national transportation system.

This concern emanated from the attempt to deal with a number of policy issues which arose in recent years, the consideration of which led to the realization that, currently, specific guidance or even general criteria to deal with these policy issues were not in effect. Further, there was lack of an adequate framework within which these criteria could be developed.

The major policy issues which have emerged in recent years are **diversification, future financing** requirements and the need for a **performance framework** to enable effective evaluation of the Crown corporations. A prerequisite to effective resolution of these issues is the clear identification of the **role** and **objectives** for each Crown corporation.

Only on the basis of a clearly defined role statement for each corporation can the government and the corporation begin to resolve the current and future issues. Therefore

the **role** definition is the first step in the effective resolution of the policy issues.

Concerning **diversification,** a number of factors should be considered in determining the appropriateness of particular diversification proposals. They include an examination of the impact of the proposals on: i) the long-term commercial viability of the corporation; ii) the productivity and efficiency of the existing transportation system; iii) the main or principal role of the corporation; and iv) the financial burden on the government.

With regard to future **financing,** the factors that need to be taken into account relate to the source and method of equity financing and they include: i) the corporate debt/equity ratio; i) the implications of private equity financing; iii) the provision of government equity; and iv) the possibility of divestiture as a source of funds.

The final issue is the need for a **performance framework.** Difficulties arise in measuring the performance of Crown corporations based on market criteria because of the non-commercial activities which are sometimes undertaken to achieve certain government objectives. Two approaches are proposed to measure annual performance: i) the development of annual goals or performance agreements based on a recognition of specific government-directed activities; or ii) the comparison of performance against a longer term corporate plan.

APPENDIX A

LIST OF TRANSPORTATION CROWN CORPORATIONS [9]

Air Canada (and subsidiaries)
Canadian National Railways (and subsidiaries)
Harbour Commissions[10]
- Belleville
- Fraser River
- Hamilton
- Lakehead
- Nanaimo
- North Fraser
- Oshawa
- Port Alberni
- Toronto
- Windsor
- Winnipeg and St. Boniface

National Harbours Board
Northern Transportation Company Limited (and subsidiaries)
Pilotage Authorities
- Atlantic
- Great Lakes
- Laurentian
- Pacific

The St. Lawrence Seaway Authority
The Seaway International Bridge Corporation Limited
VIA Rail Canada Incorporated

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[9] Source: Royal Commission on Financial Management and Accountability, Lambert Commission Report, March 1979.

[10] These Commissions are not considered to be Crown corporations by the government as not all of their members are appointed by the Governor in Council. Refer to Section 2(3)(c) of Ex-Bill C-27, November 26, 1979.

APPENDIX B

THE COMMERCIAL TRANSPORT CROWN CORPORATIONS[11]

In this section, the three Crown corporations under study are described with a summary of their legislative powers, an outline of their objectives and role as viewed by their corporate managements and a detailed summary of the activities with which each corporation is involved.

CANADIAN NATIONAL

1. Background

After World War I, there were five large railroad systems in Canada, one government-owned and the rest privately-owned. Three of the private systems were close to bankruptcy with little hope of becoming solvent. In a series of steps taken between 1917 and 1923, these systems were brought together with the single government-owned system to become Canadian National, formal incorporation of which occurred in 1922. Like its privately-owned counterpart, Canadian Pacific, CN grew to be "more than just a railroad" with motor carrier, marine and intermodal components.

2. Role and Objectives

Under its existing Act of incorporation, CN may do the following:

a) manage and operate all railway lines and railway works comprised in the National Railways;

b) carry on all business that is customarily carried on by express companies;

c) establish, construct or acquire by purchase, lease or otherwise and maintain and operate telecommunication facilities, systems and services in Canada and elsewhere, and may also carry on a public telecommunication business;

d) buy, sell, lease or operate motor vehicles of all kinds for the carriage of traffic in conjunction with or substitution for the rail services under its management;

e) "construct, purchase, lease or otherwise acquire, charter, own, maintain, operate and manage vessels, motor-

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[11] Mr. J. Young carried the primary responsibility for the development of this appendix.

ships, steamships, tugs, car ferries, dredges, lighters, barges, boats and water craft of every description... and sell or dispose thereof and it shall be entitled to charges, fares and freight for traffic carried on such vessels";

f) "purchase, lease or otherwise acquire or provide, hold, use, enjoy and operate, as well in Canada as in such other places as are deemed expedient, and either in any other company comprised in National Railways, such lands, water lots, wharfs, docks, dockyards, slips, warehouses, elevators, hotels, offices and other buildings as it may find necessary and convenient for the purposes of National Railways, and enter into agreements respecting the use thereof, and sell or otherwise dispose thereof; and may carry on the business of warehousemen and wharfingers, and charge wharfage and other dues for the use of any such property"; and

g) "with the approval of the Governor in Council, acquire, hold, guarantee, pledge and dispose of shares in the capital stocks, bonds, notes, securities or other contractual obligations whatever of any railway company or any transportation, navigation, terminal, telecommunication, express, hotel, electric or power company or of any other company authorized to carry on any business incidental to the working of a railway, or any business that in the opinion of the Board of Directors may be carried on in the interests of the National Company."

The provisions outlined above define the types of businesses which CN may carry on in addition to its major railway functions and also includes the areas in which it may make securities investments. The limitations appear to be quite clear except for those related to investments opportunities (refer to (g) above) wherein it is stated that securities may also be acquired in "...any business that in the opinion of the Board of Directors may be carried on in the interests of the National Company".

CN's initial objective was to operate a railroad. However, its objectives became more diversified and specific as the company matured. At the present time, CN's major interest is concentrated in the rail sector. In addition, it operates trucking, express, telecommunications, marine, hotels and restaurants, consulting and real estate services. It also has partial interests in a number of related areas through investments in securities of the particular companies. These are described in more detail in the next section (3).

The government's powers include the appointment of Corporate Directors, including the Chairman, and it also approves the appointment of the President. The corporation's capital

stock is held in trust for the government by the Ministers of Transport and Finance.

The underlying mandate or purpose of the company as viewed by corporate management is a commercial one. However, in testimony before the Senate Standing Committee on Transport and Communications, December 3, 1980, the President of CN, R. Bandeen, stated that the company has an extra mandate (vis-à-vis Canadian Pacific) because it is owned by the country. This mandate involved that of extending into areas and providing service perhaps beyond what a purely commercial operator might provide. However, in recognition of the underlying commercial objectives of the company, he asserted that while it has a mandate to perform "in the national interest", losses arising from national purpose operations had to be made up elsewhere, i.e. cross-subsidization from other railway users if compensation is not provided, which is not considered a satisfactory method of resolving the problem. However, Mr. Bandeen stated that "CN has no mandate for that". He indicated that if losses from such services were not underwritten and CN is not commercially viable, financing would have to be provided in some other way.

There are a number of issues which CN believes will require resolution in order to meet its commercial objective, including the question of compensation for operations undertaken in the national interest. These are:

a) losses from grain transportation, Terra Transport, and express;

b) large amounts of capital required over the decade (about $12 billion) to achieve growth, diversification and increased productivity, of which the majority will be for railway capacity expansion;

c) accessibility to all forms of financing to raise CN's capital requirements (including some form of equity financing) in order that the corporation's financial integrity is not threatened by an unacceptably high debt ratio; and,

d) erosion of the company's ability to compete in a commercial environment as a result of having to respond to specific government requests which are not applied uniformly across the business sector.

3. Interest of Canadian National

The Canadian National Railway System has interests concentrated in the areas of railway, trucking and express, marine transportation, communications, hotels and restaurants and real estate, as well as interests in a variety of other

areas. CN uses a variety of means to maintain these interests, including wholly-owned subsidiaries and their divisions, holding companies, as well as jointly operated companies and investments in other companies. In total, the Canadian National Railway System consists of about 54 consolidated companies and 20 companies which are jointly-operated or in which the system has investments. Some of the companies are not operating, either because they are currently inactive or because they were set up merely as shells. The nature of the company's business is described below, along with some financial data, including for some wholly-owned companies, CN's ledger value of the companies and for partly-owned companies, CN's total investment.

Railway Interests

The Canadian National Railway Company is the principal component of Canadian National Railways (CN) which in turn owns the Grand Trunk Corporation. The Grand Trunk Corporation in turn owns a number of United States Railway companies operating in the United States.

Canadian National Railway Company - operates a transcontinental railway and other services in Canada and the United States and owns, and has interests in, the following railway companies:

i) Wholly-Owned (ledger value in brackets as of December 31, 1980).

Grand Trunk Corporation - described below.

Minnesota and Manitoba Railroad Company ($0.4 million);

The Canada and Gulf Terminal Railway Company ($2.5 million);

Mount Royal Tunnel and Terminal Company (Consolidated) and,

The Quebec and Lake St. John Railway Company (Consolidated).

ii) Jointly-Owned (total investment in brackets)

The Shawinigan Falls Terminal Railway Co. ($39.6 thousand) joint-ownership with the C.P.R., 50-50;

The Toronto Terminals Railway Co. ($10.9 million) joint-ownership with the C.P.R., 50-50.

iii) Majority-Owned

Canadian Northern Quebec Railway Company (Consolidated) (shares held through The Northern Consolidated Holding Co. Ltd.);

Grand Trunk Corporation ($239.1 million) is wholly-owned by the Canadian National Railway Company. It is a holding company that owns several U.S. railways and has interests in several others, as well as some other interests. The Corporation contributed a consolidated profit of $9.1 million in 1980 to CN's income.

i) Wholly-Owned

Central Vermont Railway Inc. (ledger value $1.00) - earned profit of $2.0 million (U.S.) before income tax from operating revenues of $20.8 million (U.S.) in 1980.

Duluth, Winnipeg and Pacific Railway (ledger value $1.00) - earned $11.0 million (U.S.) before taxes on revenues of $37.2 million (U.S.).

Grand Trunk Western Railroad (ledger value $1.00) - incurred a loss of $5.2 million (U.S.) in 1980 before an income tax credit.

Detroit, Toledo and Ironton Railroad Co. - purchased in 1980 (net assets of $19.8 million were acquired).

ii) Partly-Owned (total investment in brackets)

Chicago and Western Indiana Railroad Co. ($6.1 million) - 20% CN-owned.

The Belt Railway Company of Chicago ($0.6 million) - 7.69% CN-owned.

Trucking and Express

i) Wholly-Owned (ledger value in brackets) CN owns the following trucking companies:

Canadian National Transportation Ltd. ($500.00)

Chalut Transport (1978) Ltd. ($94.0 thousand)

Chapman Transport Limited ($2.3 million)

Cronin Transport ($516.3 thousand)

Eastern Transport Limited ($727.6 thousand)

Empire Freightways Limited ($573.4 thousand)

Hoar Transport Company Ltd. ($843.0 thousand)

Husband International Transport (Ont.) Ltd. ($103.4 thousand)

Husband Transport Limited ($2.1 million)

Midland Superior Express Ltd. ($3.2 million)

Provincial Tankers Limited ($825.7 thousand)

Royal Transportation Limited ($272.3 thousand)

Swan River - The Pas Transfer Ltd. ($933.1 thousand)

The Toronto-Peterborough Transport Co. Ltd. ($2.3 million)

Transport Husband (Quebec) Ltd. ($6.0 thousand)

Canadian National Transfer Co. Ltd. (Consolidated)

CN also owns Canadian National Express which had a loss of $53.1 million in 1980.

ii) Jointly-Owned

Along with the Government of Quebec, CN has acquired Les Entreprises Bussières Ltée. which has the following trucking companies:

Rimouski Transport Ltd., Speedway Express Ltd. Overnight Express (1980) Inc. and BelleChase Transport Inc. Les Entreprises Bussières had a profit of $57 thousand in 1980 (April 1 to Dec. 31, 1980).

Marine

i) Wholly-Owned

CN Marine Inc. - operates ferries servicing the Atlantic provinces and the United States on contract with the federal government. CN Marine Inc. had a profit of $8.7 million in 1980.

CNM Inc. - a holding company for marine ventures, other than those operated under contract with the federal government, has the following wholly-owned subsidiaries:

Coastal Transport Limited - provides a ferry service between Black's Harbour and Grand Manan Island; and the

Newfoundland Dockyard at St. John's. It also has part interest in Halifax Industries (Holdings) Limited and Seabase Limited, described below. CNM Inc. had a profit of $0.1 million in 1980.

ii) Partly-Owned (total investment in brackets)

Cast Group of companies which operates a North Atlantic container line; CN holds 18% of the voting stock of both Eurocanadian Shipholding Limited ($61.5 million) and Intercast S.A. ($100 thousand), the parent companies:

Halterm Limited ($2.5 million) - 33% CN-owned, operates a container facility at Halifax;

Halifax Industries (Holdings) Limited ($472.6 thousand) - 50% owned, operates a shipyard at Halifax and a ship repair facility in Dartmouth;

Seabase Limited ($65.0 thousand) - 15% owned, provides shore based services for drilling rigs and other facilities;

Compagnie de Gestion de Matane Inc. ($177.7 thousand) - 49% owned, operates a rail port at Matane and rail ferry into lower St. Lawrence.

Communications

i) Wholly-Owned (ledger value in brackets)

NorthwesTel Inc. - provides public telephone and telecommunications service to Northern B.C., the Yukon and Western N.W.T.; earned income of $9.0 million on revenues of $38.1 million in 1980.

Terra Nova Telecommunications Inc. - provides public telephone and other telecommunication services in parts of Newfoundland and earned income of $3.1 million in 1980.

Grand Trunk Radio Communications Inc. ($1.0 thousand) - provides radio service to the Grand Trunk Western Railroad.

ii) Majority-Owned

Canadian National Telegraph Company ($525.9 thousand) - and its subsidiary the Great North Western Telegraph Company of Canada ($366.8 thousand); 94.5% owned.

iii) Partly-Owned

CNCP Telecommunications Ltd. - 50-50 partnership with CP. In 1980 CN's share of the assets, liabilities, revenues and expenses were respectively $34.0 million, $15.7 million, $118.8 million and $88.3 million.

Telesat Canada (total investment $2.3 million) - 3.75% owned.

Hotels and Tower

i) Wholly-Owned (ledger value in brackets)
Canadian National Hotels (Moncton) Ltd. (Consolidated) - which owns and operates a hotel;

CN Tower Limited (20,006 shares) and CN Tower Restaurants Ltd. (5 shares);

CN (France) S.A. ($1.9 million) - which leases a hotel and runs a ticket office in France.

ii) Jointly-Owned

Hotel Newfoundland (St. John's) - 50% owned.

Real Estate

i) Wholly-Owned (ledger value in brackets)

CN Transactions Inc. ($1.00) - formerly Canadian National Realities Limited, Grand Trunk Land Development Corporation ($1.00) and DTI Enterprises Inc. - all of which are concerned with developing real estate in conjunction with the railways.

ii) Partly-Owned

Canaprev Inc. (total investment $250 thousand) - 50% CN owned; started to reconstruct a CN building in Montreal.

CN Exploration Inc.

Wholly-owned. Manages CN properties with known or potential mineral rights, particularly with respect to oil or gas and undertakes the development of such property directly or indirectly in a manner to maximize return on available assets.

Other Companies

i) Wholly-Owned (ledger value in brackets)

Autoport Limited (negative value of $1.6 million) - maintains areas to unload automobiles from ships.

The Canadian National Railways Securities Trust ($342.0 million) - holds ownership of securities assigned to it from the 1937 capitalization Act.

Canac Consultants Limited ($4.0 thousand) - consulting company specializing in railways, produced a net income of $0.8 million in 1980.

Canat Limited ($5.2 million) - collected incentive per diem charges for cars held in U.S. and owns and manages equipment bought with proceeds.

Domestic Two Leasing Corporation ($1.00) - company to facilitate ownership of equipment for the automatic identification of cars for U.S. railroads.

The Minnesota and Ontario Bridge Co. ($100 thousand) - company that owns a bridge over Rainy River.

Inactive:

Canaven Limited ($6.00) - Started to submit bid for railway in Venezuela.

Domestic Three Leasing Corporation ($1.00) and

Domestic Four Leasing Corporation ($50.00)

ii) Partly-Owned (total investment in brackets)

Computer Sciences Canada Ltd. (written off) 7.87% owned computer services company.

The Public Markets Ltd. ($700 thousand), 50-50 ownership with C.P. - company to handle stock yards in Winnipeg.

Trailer Train Company ($578 thousand), $2.44% owned - company set up by 29 railways in the U.S. to facilitate the carrying of trailers on trains.

AIR CANADA

1. Background

Air Canada (then Trans Canada Air Lines) was established in 1937 for many of the reasons which had led to the building of the CPR some 50 years earlier: American interests were offering to operate a trans-Canada service; national defence; carriage of mail; and general economic progress. Since that time, Air Canada has evolved into a major world airline with domestic and international passenger, freight and related services.

2. Role and Objectives

Under the current Act of Incorporation, the "Air Canada Act, 1977", Section 6 specifies the types of activities with which AC may become involved. Its capacities and activities include, inter alia, the following, i.e., the corporation may:

a) operate an air carrier business and also "...acquire... and operate as necessary or incidental to the operation of the corporation's business aircraft, hotels and other accommodations, surface vehicles and facilities...";

b) "...acquire...and operate facilities and equipment for operating, housing, servicing and maintaining aircraft and surface vehicles";

c) "buy, sell, lease...and operate services, facilities, and equipment for organizing and conducting tours, catering and providing other passenger related services including reservations...";

d) "buy, sell,...operate and provide such computer and teleprocessing systems and technical, advisory and consulting services as may be required for, or reasonably provided by, the Corporation in conducting its business";

e) "acquire and hold shares or debt obligations of any other body corporate carrying on activities similar or incidental to those of the Corporation and sell or otherwise deal with such shares or debt obligations" subject to the authorization of the Governor in Council where the acquisition would result in the establishment of a subsidiary; and

f) "do such other things as are necessary or incidental to the carrying out of its activities".

The types of businesses which AC may acquire and operate are clearly spelled out as are the areas of investment opportunities.

The Act also gives recognition to the fact that the Board of Directors should have "due regard to sound business principles, and in particular the contemplation of profit" in performing its responsibilities. In addition, provision is made for compensation to be paid to the corporation for any losses incurred as a result of complying to "directors of a general nature given to it by order of the Governor in Council".

The government also possesses a number of other powers with regard to the company, including:

a) the appointment of the Chairman and the President;

b) the issuing of directives of a general nature;

c) the approval of loans for a term longer than 18 months;

d) the purchase of shares of the corporation (the authorized share capital is $750 million); and

e) the lending of money to the corporation and guaranteeing loans up to a maximum of $750 million.

Air Canada's objectives revolve around the corporation's primary goal of maintaining its position as a commercial enterprise.

At the present time, AC's major activity is the operation of passenger and freight airline services. A wholly-owned subsidiary organizes tour packages and other travel services. It also has joint interests in another airline, an airline brokerage firm, cargo services and small investment interests in other air related facilities and services. These are described in more detail in the next section (3).

A number of issues have been identified which will require resolution in order for Air Canada to achieve its objectives. These are:

- declining growth in its traditional commercial air transportation business due to increased competition and the erosion of markets;

- the changing nature of the labour force;

- the changing consumer;

- the need for improved productivity of money, machines and manpower;

- energy supply and price impact;

- the relationship with the owner; and

- the freedom to grow as other Canadian airlines can.

Senior officials of Air Canada have recently been raising these and other issues in public forums. A/C officials see the corporation moving into such activities as freight forwarding, telecommunications and hotels as a natural outgrowth of its basic air carrier business. Recent company proposals have also included the promotion of the concept of a single international carrier to achieve economies of scale and lower costs in this slow growth market.

3. Interests of Air Canada

i) Wholly-Owned

Touram Inc. - organizes package tours and other travel-related services; had a net income of $120,000 on total sales of $3.5 million.

ii) Jointly-Owned (percentage owned in brackets)

Nordair Ltd. (86%) - a Quebec-based regional airline, contributed $1.9 million to Air Canada's income in 1980. In 1980 it had revenues of $125 million and a net income of $2.7 million.

Guinness Peat Aviation Ltd. (29%) - acts as lessor and broker for new and used commercial aircraft. Air Canada received $0.9 million in 1980.

Matac Cargo Ltd. (50%) - owns cargo facility at Mirabel and produced a net income of $137 thousand on revenues of $3.1 million in 1980.

In addition, Air Canada has varying interests in nine other companies which are invested in, in order to obtain specific services: These are:

Airline Maintenance Building Inc. (100%) - which has a lease on land on which Air Canada owns a building.

Air Transit (100%) - STOL Company.

Air Jamaica (4.9%).

Aeronautic Radio Inc. (one share).

Air Cargo Facility Inc. (2.5%) - owns air cargo facility at Cleveland, Ohio.

Airlines Clearing House (one share).

Airline Tariff Publishing Company (6.7%).

International Air Radio Caribbean Ltd. (1%).

Société Internationale de Télécommunication Aeronautique (1%).

NORTHERN TRANSPORTATION COMPANY LIMITED

1. Background

NTCL was incorporated in 1934 as a subsidiary of Eldorado Gold Mines Ltd. under the laws of Alberta. Eldorado (now Eldorado Nuclear) was expropriated under the War Measures Act in 1944 and consequently, NTCL, as a subsidiary, came under Crown ownership. Federal incorporation occurred in 1947 but NTCL's ties to Eldorado were not officially broken until 1975. The company is a common carrier in the Mackenzie River watershed, the western Arctic and Hudson Bay, and operates trucking services in Alberta and the Northwest Territories through a wholly-owned subsidiary.

2. Role and Objectives

Under its original letters patent, the purposes for which NTCL was incorporated included the following:

a) "to carry on in all its branches a general transportation business by land and water";

b) "to carry on the business of towing, wrecking and salvage in all and any of their branches, ...";

c) "to design, lay out, construct, purchase...or otherwise acquire,...develop, repair,...operate, manage,...or otherwise deal with and dispose of all things of any character whatsoever that may be necessary in connection with the operation of the business of the company; and

d) In connection with the business outlined above;

- "to build, purchase, lease,...and operate vehicles, motor cars, motor trucks,...vessels and boats or other vehicles or vessels propelled by any power whatsoever;

- to carry on the business of general agents, ... wharfingers and warehousemen;

- to prospect, buy, acquire,...and deal in lands, natural resources and mining claims, or any interest therein;

- to carry on in all its branches a general contracting, building and construction business;

- to carry on in all its branches the business of an electric light, heat and power company, provided...;

- to conduct and operate hotels, lodging houses, restaurants and boarding houses;

- to carry on in all its branches the business of fur traders; and

- to purchase and otherwise acquire,...and deal with property, real and personal and any interests therein and rights of all kinds."

In addition, the operations of the company are to be carried on throughout Canada and elsewhere.

(As a result of the corporation's continuance under Section 181 of the Canadian Business Corporations Act [June 24, 1977] the original letters patent and the purposes of the corporation as outlined above are no longer valid. They are included here only for purposes of background.)

NTCL's primary emphasis is on the provision of government-related services. This emphasis is as much a function of its operating environment as it is a response to its role as a Crown corporation.

Traffic carried in support of resource exploration activities, including possible pipeline construction, has tended to fluctuate widely in the past due to the uncertainties involved with these activities. However, at the present time, the Company expects total traffic demand to increase significantly in the next five years.

Fairly substantial capital expenditures are forecast to meet the anticipated growth, the replacement of aging marine equipment and to upgrade the scientific equipment of two seismographic/geotechnical vessels to meet anticipated charters from the petroleum exploration industry. The majority of the funds required to finance the required equipment will be borrowed from the private markets.

The corporation has recognized that it is an instrument of national purpose and that it should be responsive to the government's social and environmental policies. For example, the provision of services to the Keewatin District of Hudson Bay is provided under terms specified by the government as being in the public interest.

A number of issues have been identified which will require resolution in order for NTCL to achieve its objectives. These are:

- a significant increase in the level of federal government financial support to transportation infrastructure in the Mackenzie River incorporating dredging of the navigational channel of the river to provide a guaranteed adequate depth even during low water seasons, at an estimated cost of $75 million (the government at present provides naviga-

tional aids on the Mackenzie River and icebreaking services on the Arctic Coast);

- a resolution of barriers to construction of transportation systems (e.g. pipelines) for southward movement of natural resources, i.e. native land claims or environmental protection interests;

- provision of adequate incentives to encourage private sector risk taking in frontier exploration due to the high costs and uncertainties involved; and

- a continuation of the current restrictive stance toward the licensing of new equipment and operators on the Mackenzie River to provide a continuing stability of service and financial performance.

3. Interests of NTCL

NTCL has a wholly-owned subsidiary, Grimshaw Trucking and Distributing Ltd., which provides general merchandise trucking service from Calgary and Edmonton, Alberta to the north. In 1980 Grimshaw made a profit of about $500,000 on revenues of about $9.0 million.

Another subsidiary, Yellowknife Transportation Company Limited, has been inactive since 1966. It was reactivated in 1980 and its name changed to Nortran Offshore Limited; this subsidiary owns and operates two seismographic/geotechnical vessels available for worldwide charter, primarily to the oil and gas exploration industry.

SUMMARY

CN, AC and NTCL have origins which resulted from particular public needs and aspirations. The three companies have evolved in a commercial environment in which they exhibit economic performances similar to their industry competitors. The expressed views of corporate management are that they will continue to act like their privately-owned competitors unless they are directed to do otherwise.

The following table presents a summary comparison of financial performance for these three commercially-oriented transportation Crown corporations for the latest year for which results are available.

TABLE I

	CN (1981)	Air Canada (1981)	NTCL (1981)
Revenues	$4,285.8M	$2,258.2M	$46.5M
Net Income	$ 193.2M	$ 40.1M	$ 7.2M
Dividend Payment	$ 38.6M	$ 13.2M	--
Return on Investment	7.8%	7.2%	10.6%
Capital Expenditures	$ 666.5M	$ 472.4M	$12.7M
Debt/Equity Ratio	36/64	57/43	53/47

The issues identified by the Crown corporations as requiring resolution before their objectives can be met are very similar to the issues facing their competitors. Their response to these issues is shaped by aspects of ownership, control and direction which differentiate crown from private corporations.